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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 524

CHEMICAL BANK & TRUST COMPANY, AS TRUSTEE UNDER THE INDENTURE, DATED AS OF DECEMBER 1, 1926, SECURING THE MISSOURI PACIFIC SECURED SERIAL BONDS,

Petitioner,

v.

GROUP OF INSTITUTIONAL INVESTORS HOLDING FIRST AND REFUNDING MORTGAGE 5% BONDS OF MISSOURI PACIFIC RAILROAD COMPANY, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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IN THE

Supreme Court of the United States

October Term, 1951

No.

CHEMICAL BANK & TRUST COMPANY, as Trustee under the Indenture, dated as of December 1, 1926, securing the Missouri Pacific Secured Serial Bonds,

Petitioner,

v.

GROUP OF INSTITUTIONAL INVESTORS Holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, Chemical Bank & Trust Company, as Trustee under the Indenture, dated as of December 1, 1926, securing the Missouri Pacific Secured Serial Bonds, respectfully prays for a writ of certiorari to the Court of Appeals for the Eighth Circuit to review a judgment, entered August 14, 1951, affirming a decision of the District Court for the Eastern District of Missouri, Eastern Judicial

Division, which approved a plan of reorganization for Missouri Pacific Railroad Company and various subsidiary companies.

Summary Statement of the Matter Involved

The Secured Serial Bonds of Missouri Pacific Railroad Company, for which petitioner is Trustee, are outstanding in the hands of the public in the principal amount of $10,425,000, with accrued interest of $8,255,297 thereon as of January 1, 1948, the effective date of the plan herein referred to, making a total publicly held claim of $18,680,297.* They are secured by 121,460 shares (approximately 81.9% of the total outstanding) of the capital stock of New Orleans, Texas and Mexico Railway Company. With fourteen wholly owned subsidiaries, the New Orleans, Texas and Mexico constitutes an important separately operated railroad system extending along the Gulf Coast from Brownsville, Texas to New Orleans, Louisiana and commonly known as the Gulf Coast Lines.

Proceedings for the reorganization of the Missouri Pacific and various affiliated companies, including the New Orleans, Texas and Mexico and its subsidiaries above referred to,** are pending before the Interstate Commerce Commission and the District Court pursuant to Section 77 of the Bankruptcy Act. The treatment to which the Secured Serial Bondholders are entitled under any plan of reorganization adopted in these proceedings depends essentially upon the value of the New Orleans, Texas and Mexico stock by which they are secured.

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* In addition, $1,715,000 principal amount have been purchased and are held by the Missouri Pacific Bankruptcy Trustee pursuant to orders of the District Court.

** Following the procedure used by the Commission and the courts below, the term "New Orleans" has been used herein to refer to the New Orleans, Texas and Mexico and its fourteen wholly owned subsidiaries above mentioned, on a consolidated basis.

In its Fourth Supplemental Report the Commission, after protracted discussion, found that "a reasonable future normal year's earnings available for payment of interest after Federal income taxes, will, so far as can be foreseen at this time, approximate * * * $4,700,000 for the New Orleans." (D. R. 28545).* It recognized (D. R. 28558, 28561) that the capitalization of its own $4,700,000 earnings figure at 4½%, the rate referred to throughout its Report, would produce a capitalization of $104,444,444 for the New Orleans considered as a separate company, and that similar computations from earnings figures for various actual years would produce substantially higher capitalizations.

The Commission stated, however, that "the maximum capitalization of the New Orleans as a separate company should have a reasonable relationship to the value of its property as evidenced by the amounts of $81,541,286 and $96,836,047 above stated" (D. R. 28561). The $81,541,286 figure, which is a typographical error for $82,206,158 (D. R. 26858), represents the Commission's determination of reproduction cost less depreciation of the major part of the New Orleans properties at 1946 period prices, plus net additions and betterments and land purchases through 1947, and an allowance for the investment of the New Orleans in International-Great Northern Adjustment Bonds. It does not include any value for other important New Orleans assets (R. 325-330, 766-773). The $96,836,047 figure represents the book value of New Orleans assets as of December 31, 1947.

In reliance on physical or rate-making valuation, accordingly, the Commission (D. R. 28561) limited the capitalization of the New Orleans considered as a separate company to $83,700,000, instead of the over $104,000,000 resulting from its own earnings figure. The Commission then,

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* "D. R." refers to the Fourth and Fifth Supplemental Reports of the Commission, as presented to the Court of Appeals pursuant to stipulation in a separate volume with its own pagination.

not actually setting up such a separate capitalization, proceeded to use this $83,700,000 figure as a maximum limitation upon the total principal amount of new securities issuable under a system reorganization in respect of the New Orleans properties, and accordingly in respect of the New Orleans, Texas and Mexico stock by which the Secured Serial Bondholders are secured.*

The Commission's Fifth Supplemental Report reiterated its determination that $4,700,000 will represent the normal year earnings of the New Orleans available for interest, and recognized again the over $104,000,000 capitalization resulting from this figure (D. R. 28655, 28656). Answering our objections to its procedure above described, the Commission (a) stated (D. R. 28657) that the prior decisions of this Court and of the Commission itself which were cited to it involved new capitalizations which proved in practice to be less than physical or book value, and (b) stressed (D. R. 28660) the quality of the new securities offered. It insisted, however, that "the capitalization should have a reasonable relationship to the physical value of its properties plus the value of investments and other stated additions thereto and to its investment as shown on its balance sheet" (D. R. 28658). Accordingly, the Commission reaffirmed as a fundamental factor in its conclusions that the total principal amount of new securities issued in respect of the New Orleans properties should not exceed $83,700,000, or $86,725,000 if the Class A stock above referred to be included.

"It is not required by the statute nor have we or the United States Supreme Court ever interpreted the

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* Except that it authorized the issuance of an additional 2½ shares of new Class A common stock in respect of each $1,000 par amount of New Orleans, Texas and Mexico stock, which may be taken as representing an additional $3,025,000 of capitalization (D. R. 28659). This allocation is specifically earmarked (D. R. 28584) as relating to the possible continuance of the current high level of New Orleans earnings, which were $6,522,486 in 1947 and $7,596,279 in 1948.

statute," said the Commission in its Fifth Supplemental Report, "as requiring that past, present and prospective earnings of a debtor be the only factor to be considered in determining its new capitalization * * *. In our opinion, a capitalization based solely on earnings without regard to the value of capitalizable assets as measured other than by earnings would not be justified." (D. R. 28657, 28658).

In approving the plan of reorganization when certified to it by the Commission, the District Court recognized (R. 925) that "Clearly, the Commission accorded great significance to the reproduction cost factor." The District Court squarely held, however, that "It is not a violation of the statute to regard reproduction cost new less depreciation as a maximum permissible capitalization" (R. 926).

The opinion of the Court of Appeals largely ignores these reiterated determinations of the Commission and the District Court, laying great stress (C. R. 27-29),* on various general statements by the Commission that it had fully compensated the Secured Serial Bondholders. The Court of Appeals refers, however, to "the elements of physical value which were taken into account by the Commission" (C. R. 27).

Jurisdictional Statement

The jurisdiction of the Court is invoked under Section 1254(1) of the United States Code, Title 28, Judiciary and Judicial Procedure, and Section 47(c) of said Code, Title 11, Bankruptcy.

The judgment of the Court below (C. R. 37-40) is dated August 14, 1951, and its opinion is reported in 191 F. (2d) 265. The opinion of the District Court is reported in 93 F. Supp. 832, and the Fourth and Fifth Supplemental Reports of the Commission, by which it approved the plan

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* "C. R." refers to the supplemental record of the proceedings in the Court of Appeals, filed in this Court.

of reorganization here involved, are reported in 275 I. C. C. 59 and 275 I. C. C. 203, respectively.

By order dated October 31, 1951, this Court extended the time for the filing of the petition herein to and including January 11, 1952. The date of filing of the present petition is January 11, 1952.

Question Presented

Whether, in a railroad reorganization proceeding under Section 77 of the Bankruptcy Act, physical value may be used as a limitation upon a larger capitalization or reorganization value which would result from the use of an earnings basis, particularly where the physical value so used does not include a value of all of the assets involved.

Reasons Relied on for the Allowance of the Writ

I

The decision below is in conflict with applicable decisions of this Court, and also with other decisions of the Court below and other Courts of Appeal on the same matter.

In *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526 (1941), this Court stated:

> "As Mr. Justice Holmes said in *Galveston, H. & S. A. Ry. Co.* v. *Texas*, 210 U. S. 217, 266, 'the commercial value of property consists in the expectation of income from it.' And see *Cleveland, C., C. & St. L. Ry. Co.* v. *Backus*, 154 U. S. 439, 445. Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. *It is plain that valuations for other purposes are not relevant to or helpful in a determination of that issue, except as they may indirectly bear on earning capacity.*" (Emphasis supplied)

In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523, 541 (1943), which involved a railroad reorganization under Section 77 of the Bankruptcy Act, this Court definitively held:

> "Certainly there is no constitutional reason why earning power may not be utilized as the criterion for determining value for reorganization purposes. And it is our view that Congress when it passed § 77 made earning power the primary criterion. The limited extent to which § 77(e) provides that reproduction cost, original cost, and actual investment may be considered indicates that (apart from doubts concerning constitutional power to disregard them) *such other valuations were not deemed relevant under § 77 any more than under § 77B 'except as they may indirectly bear on earning capacity.' Consolidated Rock Products Co.* v. *DuBois, supra,* p. 526. In this case the Commission followed the statute. While it made earning power the primary criterion, it did not disregard the other valuations. It considered them and concluded in substance that they afforded *no reasonable basis for believing that the probable earning power of the road was greater* than what the Commission had found it to be by the use of other standards. The Commission need not do more." (Emphasis supplied)

To the same effect have been the prior decisions of the Court below (*Temmer* v. *Denver Tramway Co.*, 18 F. (2d) 226 (1927); *New York Trust Co.* v. *Continental & Commercial Trust & Sav. Bank*, 26 F. (2d) 872 (1928), certiorari denied 278 U. S. 644 (1928)); of other Courts of Appeal (e.g., *Akron, Canton & Youngstown Ry. Co.* v. *Hagenbuch*, 128 F. (2d) 932, 939 (C. C. A. 6th, 1942), certiorari denied, 318 U. S. 794 (1943)); and of the Commission itself in other cases (e.g., *Chicago Great Western Railroad Company Reorganization*, 247 I. C. C. 193, 195 (1941); *Chicago, Rock Island & Pacific Railway Company Reorganization*, 242 I. C. C. 298, 390-391 (1940)) and earlier in these

reorganization proceedings themselves (*Missouri Pacific Railroad Company Reorganization*, 257 I. C. C. 479, 522 (1944)).

By authoritative decisions of this Court, as well as prior holdings of the courts below and of the Commission itself, it is thus conclusively established that in both corporate and railroad reorganizations earning power is *the* criterion of reorganization value and other valuations, such as physical or rate-making value, are not relevant or helpful except as they may indirectly bear on earning capacity. Yet it is clear that this last-mentioned qualification represents the one use which the Commission did *not* make of physical value in the present case. The Commission determined in its Fourth Supplemental Report and reiterated in its Fifth Supplemental Report a normal year earning capacity for the New Orleans, recognized the earning power capitalization resulting from this determination, and then consciously and avowedly reduced this earning power capitalization in order to limit it approximately to physical value. The arbitrary limitation by this improper legal standard of the capitalization of the New Orleans, or in other words of the total principal amount of new securities issuable in respect of its properties, renders the Commission's plan unfair and inequitable to the Secured Serial Bondholders who are secured by the New Orleans, Texas and Mexico stock.

There is likewise no justification in the decisions of this Court or elsewhere for the suggestions of the Commission and the District Court that physical value, though otherwise irrelevant, may operate as a maximum limit beyond which value based upon earning power cannot be recognized. Such a rule would inevitably deprive the owners, in the present case the Secured Serial Bondholders, of a portion of the economic or commercial worth of their property, which represents its reorganization value. This is particularly true when as in the present case, contrary to

the apparent suggestion of the District Court (R. 926), it is not proposed that the Secured Serial Bondholders shall own the equity in the New Orleans properties following the reorganization. Instead, it is proposed that they shall convey these properties to a reorganized system company for a price in new securities limited below actual economic value by the application of this improper legal standard. Such a suggestion is contrary to the express declaration of this Court in the *Milwaukee* case; and the Commission itself has recognized in these very proceedings* that reorganization value (which it termed "the actual worth of the properties to their owner") may be greater than physical or rate-making value.

Similarly, the reliance by the Court of Appeals on general language of the Commission, and its statement (C. R. 28) that "The Commission was convinced that the New Orleans did not have a value in excess of $83,700,000", overlook the fact that any such determinations are fundamentally bound up with the application of an improper legal standard by the Commission as above described. The Commission's limitation of the "capitalization" of the New Orleans to $83,700,000 was *not* used solely from the standpoint of the "public interest" in a proper capitalization as the Court of Appeals suggests (C. R. 28), *but as an actual maximum limitation on the total principal amount of securities to be issued in satisfaction of the private rights of the Secured Serial Bondholders.* Until the proper legal standard of earning power has been given full application in the determination of the reorganization value of the New Orleans properties, questions of the principal amount and quality of the new securities which will satisfy those rights cannot possibly be properly determined.

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* *Missouri Pacific Railroad Company Reorganization*, 257 I. C. C. 479, 522 (1944), quoting with approval the Commission's determinations in *Chicago Great Western Railroad Company Reorganization*, 247 I. C. C. 193, 195 (1941).

All of the foregoing is particularly emphasized by the fact that the so-called physical value used as a maximum limitation does not even include substantial properties owned by the New Orleans, a fact ignored by the courts below. Thus allowances of working capital made by the Commission in physical valuations represent not the amount of working capital which a carrier actually has, but a judgment of the Commission's Bureau of Valuation as to the amount necessary to enable it to conduct its carrier activities (R. 325-330). The record establishes (D. R. 28505, 28511) that as of the effective date of the Commission's plan the New Orleans had over $3,000,000 of working capital in addition to that included in the physical valuation. Similarly, additional cash funds of $1,511,887 in Account 704, Capital and Other Reserve Funds, $256,866 in Account 704½, Maintenance Funds, and approximately $3,260,000 of bridges and other physical assets in Account 702½-B, Donations and Grants, are not included in the physical value used by the Commission (R. 766-773). Even if, contrary to all precedent, the physical value of the New Orleans properties could be used as a maximum limitation upon the new securities to be issued therefor, a physical valuation which does not even include approximately $8,000,000 of these properties cannot possibly be used as such a limitation.

II

In the alternative, the decision below has decided an important question of Federal law which has not been, but should be, settled by this Court.

We have hereinbefore shown, we believe, that the application of physical value made in these proceedings by the Commission and the courts below is squarely in conflict with the decisions of this Court in the *Consolidated Rock Products* and *Milwaukee* cases, and with the prior decisions

of various Courts of Appeal and the Commission itself above cited. If, however, the suggestion should for any reason be upheld that these cases can be distinguished on the ground that the earnings valuations there involved were less than the physical values, then it is submitted that the present case presents an important question of Federal law which has not been, but should be, settled by this Court.

The decisions above referred to held earning power, the justified expectation of the owners of property of income from it, to be the criterion of reorganization value. There is no intimation that the value so determined is to be limited by physical or rate-making value, and as has been pointed out,* any such limitation would deprive the owners of the property of part of its economic value. Both for the present case and as a guide to the courts below in future reorganization proceedings any such suggestion, if not specifically contrary to prior decisions, should now be definitely repudiated by this Court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may be issued out of and under the seal of this Court, directed to the Court of Appeals for the Eighth Circuit, commanding that court to certify and send to this Court, on a day certain to be therein named, a full and complete transcript of the record and of all proceedings in the cause numbered and entitled on its docket, "No. 14,272, Chemical Bank & Trust Company, as Trustee under the Indenture, dated as of December 1, 1926, securing the Missouri Pacific Secured Serial Bonds, Appellant, *vs.* Group of Institutional Investors Holding First and Refunding Mortgage 5% Bonds of Missouri Pacific Railroad Company, et al., Appellees", to the end that said cause may be reviewed and determined by this Court; that the judgment of said Court of Appeals entered in said cause

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* See pp. 9-10, *supra*.

be reversed; and that your petitioner be granted such other and further relief as to this Honorable Court may seem just and proper.

Dated, January 11, 1952.

Respectfully submitted,

EMMET MCCAFFERY
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New York 6, N. Y.
Attorney for Chemical Bank & Trust Company, as Trustee as aforesaid.

DORR, HAND & DAWSON,
Of Counsel.

APPENDIX

The pertinent provisions of Section 77 of the Bankruptcy Act (11 U. S. C., Sec. 205) are as follows:

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) hereof. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) hereof, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided,* That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further,* That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be

adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided,* That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the

respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): *Provided further,* That if, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further,* That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis

which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."